Internal Revenue Service
memorandum

CC:TL:Br3
JCDonovan

date: JAN 4 1991

to: District Director, Manhattan
Attn: Robert Wein

from: Assistant Chief Counsel (Tax Litigation) CC:TL

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subject: Re: [redacted]

Your reference: E:CE:4:1476:RWein

This is in response to your inquiry to the Department of Justice regarding the claims for refund filed by the subject taxpayers for the tax years [redacted] and [redacted].

ISSUE

Whether the taxpayers may successfully apply the mitigation provisions of the Internal Revenue Code, I.R.C. §§ 1311 - 1314, or the informal claim theory to validate the otherwise untimely refund claims filed for [redacted] and [redacted].

CONCLUSION

The taxpayers will not be able to validate their claims through the use of the mitigation provisions or the informal claim theory.

FACTS

Sometime prior to [redacted], the Service issued a statutory notice of deficiency to [redacted] and [redacted] (hereinafter collectively referred to as "[redacted]") for the years [redacted] and [redacted]. On [redacted], [redacted] filed a claim for refund for these years. The claim for [redacted] included a schedule showing a carryover to [redacted] of $[redacted] in foreign tax credits and $[redacted] in investment tax credits. The claims were subsequently disallowed. On [redacted], [redacted] filed a complaint in the United States Claims Court seeking a refund of the amount claimed. The complaint included a prayer, in the last paragraph, "for an adjustment in taxes owed by plaintiff in subsequent years due to carryover of certain foreign and investment tax credits resulting from the adjustments in income in [redacted], [redacted] and [redacted]."

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On [redacted], the United States entered into a Stipulation for Entry of Judgement ("Stipulation") in the subject case. The Stipulation provided, inter alia, that based on computations attached thereto, [redacted] was entitled to refunds of tax and assessed interest in the amounts of $[redacted] and $[redacted] for the taxable years [redacted] and [redacted] (the "suit years"), respectively. The refund arose from adjustments concerning the appropriate treatment of income and losses relating to bonds held and exchanged by [redacted]. The reduction in tax liability for the suit years caused certain tax credits, previously used to offset tax liabilities for the suit years, to become available to be carried over to offset tax liabilities for subsequent years. According to the information provided, the carryover of tax credits would create income tax refunds for taxable years [redacted] and [redacted] (the "mitigation years") in the amounts of $[redacted] and $[redacted], respectively.[1]

The Stipulation also provides: "This stipulation is not intended to prevent the potential applicability of Sections 1311 through 1314 of the Internal Revenue Code to claims for adjustment of tax liability for any taxable year to which tax credits (as indicated on Schedule 3 of the attached computation) may be carried over or carried back." Accordingly, the parties recognized the potential application of the mitigation provisions. On [redacted], the Claims Court entered judgment reflecting and incorporating the Stipulation.

[redacted] did not file formal claims for refund based on the foreign tax and investment tax credit carryovers to [redacted] and [redacted] until [redacted]. These years were open for assessment on waiver only until [redacted]. Accordingly, the claims, of themselves, are untimely.

It is unclear when [redacted] first maintained, in writing, that it was entitled to the foreign tax credits in the suit years. In order to successfully raise the mitigation provisions, it is necessary that [redacted] first maintained, in writing, that it was entitled to the tax credits in the suit years prior to the expiration of the statute of limitations for mitigation years. However, this does not appear to be an issue in this matter because the information notes that [redacted] last maintained its position prior to the expiration of the statute for the mitigation years.

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1 This response makes no comments on the proper treatment of the tax credits or the tax liability figures set forth in the information provided. We proceed on the basis that, if not barred by the statute of limitations, it would be proper to carry forward the tax credits in the amounts claimed.

DISCUSSION

Informal Claim

Despite the requirement set forth in I.R.C. § 6402 and Treas. Regs. §§ 301.6402-2 and 301.6402-3 that ~~claims~~ for refund must be submitted on I.R.S. forms, a document which fails to satisfy this requirement may, nevertheless, be considered an informal claim. If the informal claim is filed before the statutory period for filing a claim expires and perfected by a formal claim filed after the statute has run, but before the informal claim is disallowed, the formal claim will be considered timely. United States v. Kales, 314 U.S. 186 (1941).

The standards to be applied to determine whether an informal claim was filed were established by the Supreme Court in Kales. These are: (1) the issue of whether an informal claim has been filed is one of fact; (2) the informal claim must be in writing or have a written component; and (3) the matters set forth in the writing must have been sufficient to apprise the Service that a refund is sought and to focus attention on the merits of the dispute so that an examination of the claim may be commenced if the Service wishes. See also, American Radiator Standard Sanitary Corp. v. United States, 318 F.2d 915 (Ct. Cl. 1963) and Wrightsman Petroleum Co. v. United States, 35 F. Supp. 86 (Ct. Cl. 1940), cert. denied, 313 U.S. 578 (1941). "While viewed as an appropriate substitute for the timely filed formal claim, the informal claim is nonetheless based on the same fundamental premise that 'notice' to the Commissioner must be provided that a claim for refund is being made, for a sum certain, for a particular taxable period, and occurring within the applicable statutory period." Wall Industries, Inc. v. United States, 10 Cl. Ct. 82, 98 (1986), citing, Furst v. United States, 678 F.2d 147, 151 (Ct. Cl. 1982) and Newton v. United States, 163 F. Supp. 614, 618 (Ct. Cl. 1958).

The Service describes an informal claim as a "letter or other document which contains all facts necessary to determine that a reduction in tax is involved . . . ." I.R.M. § 4121.2. The writing must give the Commissioner fair notice that a refund of taxes is sought for specified years and of the basis of the claim. American Radiator, supra, at 920. Mere knowledge of an overpayment by one of the Commissioner's representatives is not enough. Hollie v. Commissioner, 73 T.C. 1198, 1215 (1980). Accordingly, it is relevant whether the written component is in a form that would cause the Commissioner to treat it as a claim. Moreover, the knowledge and experience of a taxpayer's attorney may be taken into consideration when determining the validity of a claim. Hollie, supra, at 1215. At this time, there simply is no reliable test to determine if an informal claim has been filed. "Rather, it is underscored that each case is to be decided on its own merits, paying particular attention to the combined effect of the unique facts and circumstances known to the government at the time the alleged informal claim is made." Wall Industries, 10 Cl. Ct. 82, 98 (1986).

While [redacted]'s [redacted] claim for refund included a schedule showing a credit carryover to [redacted] and its complaint requested an adjustment in taxes for subsequent years due to credit carryovers, we do not believe these writings amount to an informal claim. The focus of each of these documents is the tax liability for [redacted] and [redacted]. Indeed, when the claim for [redacted] was filed, [redacted] should have filed a claim for [redacted]. The reference to [redacted] would not cause the Service to treat these documents as claims for [redacted]. Moreover, the documents reference tax credit carryovers, not refunds. Cf. Wall Industries, 10 Cl. Ct. at 99. In light of these facts, and the factual nature of this issue, the [redacted] claim and the complaint should not be considered informal claims for the years [redacted] and [redacted]. In any event, since neither document refers to [redacted], no written component exists pertaining to this year. Thus, there was no informal claim filed for [redacted].

Mitigation

The mitigation provisions are a statutory response to the judicially created equitable doctrines of recoupment, setoff and estoppel. While they attempt to correct the same inequitable results, the equitable doctrines often produce uncertain results. Accordingly, Congress believed legislation was required to clear the murky waters. The mitigation provision, as originally enacted (1939 I.R.C. § 3801), was based on four principles:

> (1) To preserve unimpaired the essential function of the statute of limitations, corrective adjustments should (a) never modify the application of the statute except when the party or parties in whose favor it applies shall have justified such modification by active inconsistency[2] and (b) under no circumstances affect the tax save with respect to the influences of the particular items involved in the adjustment.
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> (2) Subject to the foregoing principles, disputes as to the year in which income or deductions belong, or

[2] This active inconsistency requirement is not followed by all courts. See Yagoda v. Commissioner, 331 F.2d 485 (2d Cir. 1964), cert. denied, 379 U.S. 842 (1964); Chertkof v. Commissioner, 66 T.C. 496 (1976); Priest v. Commissioner, 6 T.C. 221 (1946).

as to the person who should have the tax burden of income or the tax benefit of deductions, should never result in a double tax or a double reduction of tax or in an inequitable avoidance of tax.

(3) Disputes about the basis of property should not allow the taxpayer or the Commissioner to obtain an unfair tax advantage by taking one position at the time of the acquisition of property and an inconsistent position at the time of its disposition.

(4) Corrective adjustments should produce the effect of attributing income or deductions to the right year and the right taxpayer and of establishing the proper basis.

S. Rep. No. 1567, 75th Cong., 3d Sess. 48 (1938), _reprinted in_ 1939-1 (Part 2) C.B. 779, 865.

Unlike the equitable doctrines, mitigation actually opens the closed year to correct the erroneous treatment.

The party raising the argument has the burden of proving the appropriateness of applying the mitigation provisions. _Olin Mathieson Chemical Corp. v. United States_, 265 F.2d 293, 296 (7th Cir. 1959); _Chertkof v. United States_, 676 F.2d 984, 990 (4th Cir. 1982). To be entitled to relief, the party must show the following:

(1) A determination (as specifically defined in Section 1313) must establish that the treatment in another year was incorrect.

(2) Correction of the error in the other year must be barred by some rule of law, usually the period of limitations on assessment or refund.

(3) The party successful in the determination must have asserted a position inconsistent with a position adopted in the barred year. There are only two exceptions to this inconsistency requirements.

(4) The determination must result in one of the seven circumstances specifically described in Section 1312, _i.e._, the double exclusion of an item of income or the double allowance of a deduction.

I.R.C. § 1311.

The determination can be any one of the following:

(1) A decision by the Tax Court or a judgment, decree, or other order by any court of competent jurisdiction that has become final;

(2) A closing agreement made under Section 7121;

(3) A final disposition by the Internal Revenue Service of a claim for refund; or

(4) An agreement between the taxpayer and the Service authorized by Section 1313(a)(4).

I.R.C. § 1313.

The court's determination is merely the triggering event under mitigation. Before an adjustment may be made, the losing party must file the appropriate document (claim for refund or notice of deficiency). Benenson v. United States, 385 F.2d 26 (2d Cir. 1967); J.B.N. Telephone Co., Inc. v. United States, 638 F.2d 227 (10th Cir. 1981); 2 J. Mertens, The Law of Federal Income Taxation § 14.11, at 57 (1976).

To successfully invoke the mitigation provisions, the determination must result in one of the following "seven circumstances":

1. Double inclusion of income;
2. Double allowance of deduction or credit;
3. Double exclusion of income;
4. Double disallowance of deduction or credit;
5. Correlative deduction or inclusion regarding trusts and estates and their beneficiaries;
6. Correlative deductions and credits for related corporations;
7. Basis of property after erroneous treatment of a previous transaction.

I.R.C. § 1312.

The issue in this case presents two questions. First, does the increase in available credit carryover fall within the scope of the determination? Second, if the first question is answered in the negative, should the mitigation provisions afford relief notwithstanding?

[redacted] contends that it meets the circumstance of adjustment in I.R.C. § 1312(4) that the "determination disallows a deduction or credit which should have been allowed to, but was not allowed to, the taxpayer for another year, or to a related taxpayer." However, the determination did not disallow the credits in issue. Through other nonrelated adjustments the credits needed to reduce the tax liability to zero were decreased. This, in turn, increased the amount of credits available to be carried over to the mitigation years. Indeed, while [redacted] claims to have met the determination requirements, it admits that the credits were not the subject of the determination -- "Although the tax credits are not one of the contested issues in the case . . . ." (Letter from [redacted] dated [redacted]). [redacted] argues that if the amount of the tax computation reflects the credits, it meets the determination requirements. This is an impermissibly broad reading of the statute. A plain reading of the statute shows that the determination must disallow the deduction or the credit. While the result of the judgment of the court requires fewer credits to offset the [redacted] and [redacted] liabilities, the judgment did not disallow the credits.

> [The mitigation provisions are] predicated on the principle that correction is made only with respect to the item involved in the determination. The operation of the bar of statute of limitations is not affected with respect to any other item, even though such other item also had been erroneously treated in the same year.

S. Rep. No. 1567, 75th Cong., 3d Sess. 48 (1938), reprinted in 1939-1 (Part 2) C.B. 779, 865.

We agree with [redacted] that Rev. Ruls. 73-82, 1973-1 C.B. 375, and 73-230, 1973-1 C.B. 374, and Longiatti v. United States, 819 F.2d 65 (4th Cir. 1987), are not applicable to the current facts. However, we disagree with the position taken by [redacted] that Rev. Rul. 68-152, 1968-1 C.B. 369 and Olin Mathieson Chemical Corp v. United States, 265 F.2d 293 (7th Cir. 1959), provide support for the contention that the mitigation provisions apply to the facts at issue.

[redacted] argues that its situation is closely analogous to Rev. Rul. 68-152 (situation 1). We note that situation 1 was patterned after the Olin Mathieson case. Accordingly, any comments made regarding Olin Mathieson apply equally to Rev. Rul. 68-152 (situation 1). [redacted] argues that Olin Mathieson can be read to allow the carryover of the credits at issue. In that case the taxpayer claimed an ordinary loss deduction in 1944. Upon examination, subsequently sustained by the district court, the Commissioner disallowed the ordinary loss as being properly deductible as a capital loss. Olin Mathieson did not have any capital gains in 1944 from which the capital loss could be deducted. Accordingly, it sought, by an otherwise time barred claim for refund, to carryover and deduct the capital loss in 1945, a year in which it had significant capital gains. The

Seventh Circuit affirmed the decision of the district court that the mitigation provisions would apply to allow Olin Mathieson to open the 1945 year to carryover the capital losses. [redacted] cites the following language as support for its argument:

> [The Government's] contention is, thus, that the bar to the statute of limitations operating against the carry-over of the claim of loss to 1945 is a circumstance which did not directly result from the initial determination allowing the long term capital loss for 1944. It is clear to us, however, that taxpayer would be entitled to the loss carry-over except for the bar of the statute of limitations, and that there was, therefore, a double disallowance of a deduction as provided in § 1312(4).

265 F.2d at 296.

What [redacted] seems to ignore, however, are the last two sentences of the same paragraph in which the above language holding that the reason there was a double disallowance of a deduction is that the ordinary loss and the capital loss were the same deduction.

> It is true that they are not deductions of the same type, but there is no requirement in § 1312(4) that they be of the same type. Both the contended for, but disallowed, ordinary loss and the disallowed carry-over claim of loss are based on the identical transaction and in this sense are the same deduction.

265 F.2d at 296.

It can not be plausibly argued that the reduction in liability for [redacted] and the resulting increase in available credit carryover are based on the identical transaction or are the same deduction. While it is obvious that the credit in the determination years and the credit in the closed years are the same deduction, as was noted above, [redacted] agrees that the credit "disallowance" was a mere consequential result of the reduction in liability. Accordingly, Olin Mathieson does not support the argument that [redacted] should be able to carry over the unused tax credits.

We have considered whether requiring the determination and the issue for which relief is sought in mitigation to be identical would subject the circumstances of adjustment in paragraphs 1312(3)(B) and (4) to the requirement that "there is adopted in the determination a position maintained by the Secretary" as set forth in section 1311(b)(1). To the extent this is interpreted to impose the requirement that the Secretary or taxpayer, as the case may be, maintain an inconsistent position in the determination, we believe the interpretation would be incorrect. For example, the Tax Court recently decided the case of Pinson v. Commissioner, T.C. Memo. 1990-234. In that case the parties argued, addressed and briefed the issue of whether the petitioner was entitled to a theft loss arising out of the operation of his law partnership. In its opinion, the court, after holding against the petitioner on the theft loss issue, found, sua sponte, that the petitioner was entitled to a capital loss deduction. Neither party addressed this issue. It is our opinion that if the petitioner was eligible for capital loss carryover treatment and the mitigation provision were otherwise available, he would be entitled to raise the mitigation provisions to carry over the capital loss notwithstanding failure of the Secretary to maintain a position on this issue in the Tax Court case.

[redacted] may argue that amendments to the mitigation provisions in the 1954 Code, providing for the adjustment of consequential loss carryovers to all affected closed years, indicates congressional disposition to a broader view.[3] We disagree with this argument. The relevant amendments to I.R.C. § 1314 provided that where the correction of the error in the closed year affects other closed years by a either a net operating loss deduction or capital loss carryover, the other affected year may be adjusted to apply the net operating loss carryback or carryover or the capital loss carryover. Thus, these amendments apply to the error year, not the determination year, and refer only to the effects created by net operating losses and capital losses, not tax credits. Exceptio Probat Regulam Rebus Non Exceptus -- An exception establishes the rule to things not excepted. This has been affirmed in a multitude of cases which hold that exceptions should be narrowly construed. Accordingly, the amendments to the 1954 Code do not provide any support for the application of the mitigation provisions to the situation presented herein. For these very same reasons, [redacted] should not take comfort in the recent Tax Court decision of Bolten v. Commissioner, 95 T.C. No. 29 (October 4, 1990).

The [redacted] case provides a clear set of facts with which to obtain a court ruling on the issue. Moreover, we are not unimpressed with the potential refund which, with interest, could exceed $[redacted].

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[3] H. Rep. No. 1337, 83d Cong., 2d Sess. A292, reprinted in, 1954 U.S. Code Cong. & Admin. News 4017, 4433; S. Rep. No. 1622, 83d Cong., 2d Sess. 177, reprinted in, 1954 U.S. Code Cong. & Admin. News 4621, 5090.

CONCLUSION

Based on the foregoing we believe neither the mitigation provisions nor the informal claim theory would not operate to afford [redacted] the relief it desires. Moreover, with regard to the mitigation issue, we believe this case presents facts amenable to a clear court decision on the issue presented. If you wish to discuss this matter further, please contact Jack Donovan at FTS 566-3335.

MARLENE GROSS

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